No. 10584

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

NORTHWESTERN MUTUAL FIRE ASSOCIATION, a corporation, *Appellant,*

vs.

UNION MUTUAL FIRE INSURANCE COMPANY OF PROVIDENCE, RHODE ISLAND, a corporation, *Appellee.*

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION.

APPELLANT'S REPLY BRIEF

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APPELLANT'S REPLY BRIEF

A. APPELLEE'S STATEMENT OF THE CASE

Appellee's Brief seems to rely chiefly upon a continuous reiteration of the idea that Appellant's "net retention" was only $32,000 which is repeated over and over again and is necessarily based upon the assumption that the proper amount for calculating the deduction to be made from the gross amount of insurance on account of the existence of catastrophe excess reinsurance is the amount which the reinsured *would recover in the event of a total loss from one single cause.* This idea is repeated over and over again in all possible variations and reference is made over and over again to the testimony of Appellee's witnesses, which was drawn out from these witnesses

by reason of questions which contained these two elements of the problem for which, as we show, there is absolutely no justification.

Furthermore, Appellee's Counsel throughout the brief consistently refused to consider the fact that this catastrophe excess of loss reinsurance covers Appellant's entire business, and there is absolutely no reason for allocating any part of it to one specific property! That is to say, if the maximum amount of protection which the Appellant might receive from this catastrophe reinsurance is to be considered, that amount is $153,000. Between that amount and the amount which they would recover in the event of a loss of but $30,000 (which is nothing) there is absolutely no reason why any figure should be read into this contract.

With these general observations as to Appellee's repetitions of arguments, absolutely without any foundation either in the contract in question or the evidence, we can mention only a few of the more obvious misstatements of fact contained in Appellee's Brief.

B. THE FORCE OF THE DISTRICT COURT'S "FINDINGS OF FACT"

We have no complaint to make against the rule of law set forth in Appellee's Brief, page 14, but we respectfully submit that district courts are not given the power to make what are actually erroneous conclusions of law and by dubbing them findings of fact prevent the Appellate Court from re-examining them. The issues which the Appellant presented in this case were very simple. They were as set out in our summary on page 17 of our opening brief and thereafter

argued. In support of these claims, we challenged counsel for the Appellee to point out any evidence in the record that contradicted these claims; and after reading Appellee's Brief, we most certainly submit that they have not met that challenge. This is not a case of dispute as to the facts, as were all of the cases cited by Appellee's Counsel, but is a case where, as we will show, the evidence on the essential facts is uncontradicted.

C. APPELLANT OBSERVED THE UTMOST GOOD FAITH IN CORRECTLY STATING ITS ACTUAL NET RETENTION TO APPELLEE.

We do not question but what reinsurance, like all other executory contracts, is a matter of the utmost good faith, and we do not question but what it is a very proper action for the reinsured to inform the reinsurer prior to the making of a reinsurance contract of the existence of any excess of loss reinsurance, but our answer to this claim is that the appellant did so (See pp. 43 *et seq.* of our opening brief).

D. EVIDENCE OF USAGE WAS ADMISSIBLE

We note on pages 19 and 20 of Appellee's Brief an apparent claim that because the District Court found that the terms of Article VIII of the treaty were "plain, clear and unambiguous" that should be taken as a finding of fact. Most certainly, if a jury had been present, the court would not have instructed the jury to determine for itself whether or not the term "net retention" was "plain, clear and unambiguous" as he construction of a contract is always a question of law for the court. The question of fact consists in

whether or not there is a usage which gives to a term a certain definite meaning which might not be detected by any person who is unfamiliar with such usage.

We respectfully submit that under the law as set out on pages 18 to 21 of our Opening Brief, evidence of the usage which we alleged in our amendment (Tr. 165) was admissible. We note that counsel for the Appellee insist that one of the elements of a usage which must be proven is that "there is an ambiguity in the written contract which requires construction." In preparing our Opening Brief, we intentionally omitted all reference to the law with respect to explaining ambiguous terms, but, for the sake of brevity and conciseness, confined our statement of principles of law to the rule applicable to cases where the term to be defined would ordinarily be given a different meaning from that given to it by the usage.

Taking up the law cited by counsel for the appellant, we are much surprised to find first the citation of §24 p. 112 of 25 C.J.S. We quoted that paragraph in full at the bottom of page 20 of our Opening Brief and therefore pass it by merely calling the Court's attention to the last clause "even though the words are unambiguous in their ordinary sense." §8 of 25 C.J.S. is merely a statement of the necessity and sufficiency of the custom and usage and §33 merely states the rules as to burden and order of proof, the admissibility of evidence and the weight and sufficiency of evidence. The real answer to the question involved in this case is contained in §24, which is as we have above stated.

In all of the cases cited in the Appellee's Brief, page 21, the question involved was the admissibility of evidence of a custom which was directly contrary to some specific provision contained in the contract and in these cases the question of the admissibility of a definition by usage of a certain particular term as used in the contract was not involved. Singularly, each of these cases expressly recognized the rule for which we contend.

E. VARIOUS STATEMENTS CONTAINED IN APPELLEE'S BRIEF

We note upon Appellee's Brief, page 28, the horrible example of a direct insurer retaining $500,000 upon a particular structure and taking out an excess of loss reinsurance contract covering $499,000 of the $500,000. Our answer to that predicament is that the reinsured if it did not know this fact would be amply protected by the rules requiring good faith as set out on pages 15 to 18 of Appellee's Brief, but we most certainly insist that the Appellant fully complied with the requirement of informing the Appellee of the existence of its catastrophe excess reinsurance. If, however, the reinsured in that case was fully informed as to this $499,000 excess of loss reinsurance it always had the option of refusing the tendered cessions, but if it accepted them and made no objection it would most certainly be a gross breach of good faith in the reinsurer to accept a premium upon, say, $50,000 of a $50,000 cession of insurance and keep that premium if there is no loss, but insist that its actual liability was reduced to $1,000 in case of a loss, which is exactly what the Appellee is seeking to do in this case.

F. DEFENDANT'S EXHIBIT A-11

In answer to the situation as set out on Appellee's Brief pages 28 to 32, inclusive, we would call attention to the fact that Defendant's Exhibit A-11, the letter from the Appellee, was dated April 1, 1942. The Appellee had filed its appearance in this case in the Superior Court of King County, Washington, on February 6, 1942, nearly two months prior to the writing of this letter and there is absolutely no proof that this letter had actually been sent to all of the insurance companies therein mentioned. Naturally, therefore, the query arises: Was this letter, Defendant's Exhibit A-11, an actual bona fide letter sent to all of its correspondents or was it a mere attempt to manufacture evidence for use in the trial of this case? At any rate, the language of this Defendant's Exhibit was clearly intended to bolster up their contention that excess of loss reinsurance should be taken into account in computing net retention unless there was a specific agreement that it should not be taken into account. The Appellant, however, did not fall into the trap of signing this agreement, or of agreeing to the contents of this letter. The answer to this letter was that an excess of loss contract starting at $4800 was entirely too low; and in this connection, we would call attention to the situation with reference to the cession of reinsurance by the Appellee to the Appellant, which is referred to in our brief on page 24, wherein in the event of a loss by the Appellee of $50,000 such loss would have been reduced by its excess insurance to the sum of only $18,500. This reinsurance had been knowingly and willingly accepted by the Appellant,

ut the entire meaning of the incident to which the Appellee now refers, even assuming that Plaintiff's Exhibit A-11 was written in good faith, is that Mr. Beall thought that the reduction of the excess of loss limit to $4800 was entirely too great.

Furthermore, if this letter was actually written in good faith to all of the Appellee's reinsurers, it would indicate that the Appellee took out this excess of loss reinsurance without first obtaining the consent of their reinsurers. So long as these reinsurers failed to give that consent, they retained the option, if Appellee's contention is correct, of retaining premiums on this reinsurance in case there was no loss, but in case of a loss claiming deduction on account of this excess of loss reinsurance. It is most certainly a peculiar situation where the Appellee was making the contention that it was a perfectly proper and legitimate procedure to take such excess of loss reinsurance into account in reducing pro rata any loss on a specific reinsurance cession and yet that they should have taken out this extraordinary excess of loss reinsurance without first having obtained permission from their reinsurers.

Also, the statement of Mr. Beall found in italics at the end of the quotation from his testimony on p. 29 is entirely consistent with Appellant's contention. If the Appellee's contention is correct then the reduction of the attachment point to $5,000 would automatically reduce the reinsured's "net retention" and automatically reduce the reinsurer's liability in case of loss, but Mr. Beall's statement "I would assume they had probably cut their retention on that risk," clearly

means that he would assume that they had, by specific reinsurance cut their retention to fit the attachment point of the excess of loss reinsurance.

G. APPELLEE'S WITNESSES

In our Opening Brief, we analyzed the testimony of these witnesses and showed that the statements which appear to support Appellee's theory were mainly advice to the Court as to how it should decide the case, such advice being founded upon the interpolation of the two terms "a total loss" and "in one event."

On page 34 of Appellee's Brief, we find the remarkable statement that examples had been given by these experts of a reinsurance contract provision which "provided, as does the Treaty here, that all reinsurance, including excess of loss reinsurance, must be considered in determining and stating net retention." These witnesses did not state any such thing. We find on page 297 a clause which Mr. Edwin Stuart had himself framed *as a proper clause to express that idea*, but he himself stated "as to the second clause I read (which was this clause) I do not think it is as customary but it sets forth clearly what the net retention shall be." It will be noticed that this definition expressly and accurately states a formula which could be used in considering excess of loss reinsurance in computing net retained line; that is, that the amount deductible on account of excess of loss reinsurance of net retention should be computed by including the amount and that that amount should be the loss that the reinsured could sustain "if the loss on such risk were total and no other risk was involved in the same occurrence." Now, there is ab-

solutely nothing in this Insurance Treaty or in the documents relating to the reinsurance here in question which justifies the interpolation of those terms in this contract, but the court, in interpreting net retention as the Appellee desires, must flounder hopelessly at sea with the six different amounts which might be used for deduction purposes as we set forth on pages 51 and 52 of our Opening Brief. Now, the question occurs, why did this witness state that all these words were necessary or even proper in a clause to define "net retained lines" if the words "net retained lines" were unambiguous and meant everything that this clause of 58 words means? How long would an insurance treaty be if every expression in it which was "clear and unambiguous" required 58 words in which to define it?

The testimony of Mr. John Alden Towers contained on pages 317 and 321 is merely to the effect that provisions are frequently inserted in treaties to the effect that net retained lines shall not be considered as being reduced by any amount recoverable from excess of loss reinsurance, but that is a very different matter from a statement that net retention had ever, within the experience of the witness, been taken into account in computing net retained line.

In this connection, we might say that on pages 43 and 44 of our opening brief, we quoted exactly the extracts from the testimony of the two witnesses here cited, which positively admits that all the requirements of the reinsurance practice have been complied with if the reinsurer knows of the existence of the

excess of loss contract; but, as we have shown, the Appellee did in this case know of such reinsurance.

We note at the foot of page 34 the statement: "Where, however, the Treaty does not specifically exclude excess of loss reinsurance, it must be considered by the ceding company in determining and stating its net retention and must be noted in the cession papers." Reference is here made to Tr. 153, which is the testimony of J. M. Legris, who merely states that it is the practice of the *Appellee* when it is passing upon the question of whether it will authorize particular insurance to consult only the documents with relation to that particular transaction. It most certainly would be a nice comfortable rule of law for insurance companies if they could safely follow such a practice; that is, to close their eyes to all the information which they already have in passing upon each transaction. But how does that square with their own practice in ceding insurance such as was evidenced by Plaintiff's Exhibit 2 where their net retention was stated at $71,000, while as we showed on pages 24 and 25 of our Opening Brief a loss might very easily happen under which their net loss would be $18,500?

On page 35 of Appellee's Brief, an attempt is made to state what Appellee "without doubt would have" done if Appellee had been notified of the existence of this excess of loss reinsurance. One answer to this is that they did have this information. Another answer is that they themselves followed exactly the same practice as evidenced by Plaintiff's Exhibit 2 (See our opening brief, pages 24 and 25) and that

the Appellant had previously on many occasions accepted similar cessions, Plaintiff's Exhibit 3, as set forth and explained on Tr. 216-221. It is plain that Appellee was perfectly willing to accept cessions of reinsurance together with the premiums earned by such acceptance until a loss occurred where it was more profitable to claim that they did not know of the existence of this catastrophe excess reinsurance and thereby attempt to avoid the payment of a just claim.

H. SUMMARY OF APPELLEE'S ARGUMENT

The summary of Appellee's argument, beginning at the foot of page 35, is somewhat interesting in its inconsistencies. First it states that the definition of net retention is "couched in plain English. It is clear, definite, certain and unambiguous." In their second paragraph they state that net retention is defined in the Treaty or in the application or correspondence covering the specific cession. Now, if "net retention" defines itself, why should it be defined in the Treaty by such definitions as were proposed by the witness Edwin Stuart at Tr. 297, in which, as we have heretofore stated, it took 58 words to define this so-called "certain and unambiguous" term?

The third paragraph is not borne out by the testimony in any respect. The witness John D. Pryce, with an experience beginning in 1920 with work "almost entirely in the field of reinsurance" (Tr. 243) could remember but one occasion where excess of loss reinsurance had been so much as mentioned in a daily report (Tr. 251-252. The various experts had various clauses that they used or would rec-

ommend using, but their whole testimony upon this point and the entire recital contained in this paragraph 3 indicates that it was the universal usage not to consider excess of loss reinsurance in computing net retention.

The effect of paragraph 4 depends upon the definition of "net retention." If the definition of "amount retained net" refers only to the deduction of specific reinsurance (that is, reinsurance effected upon the one or more specific risks covered by specific reinsurance), then the remainder of the clause is a mere repetition of the same idea.

I. NO TESTIMONY THAT CATASTROPHE INSURANCE IS EVER CONSIDERED

On Appellee's Brief, page 37, we note that Counsel for Appellee has noticed our challenge to cite where it appears in the record that a single witness testified that ever in his experience had he actually seen "net retention" computed by taking into account excess reinsurance of the type of defendant's Exhibit 1. Counsel then state that we were wrong in making this statement, and that it is very plain that the ceding companies do compute their "net retention" by taking into account excess of loss reinsurance, *but they do not cite a single page in the transcript where any such testimony appears*, and this is for the simple reason that *no such testimony is in this record.* As we stated in our opening brief the witnesses for the Appellee stated two circumstances under which catastrophe excess reinsurance is admittedly not taken into account in computing net retention and evidently no transaction had ever come

to their knowledge where at least one of these circumstances had not existed. Their testimony is entirely limited to the expression of the opinion that the Appellant should have adopted one or the other of these two circumstances, and as we showed in our Opening Brief (pp. 29 *et seq*) *we had adopted both.*

Of the truth of the statement of this limitation upon the testimony of Appellee's witnesses, the extracts of the testimony of Mr. Pryce and Mr. Towers set forth beginning at the foot of page 37 of Appellee's Brief, is a fair sample of the evidence. Both of these witnesses in these extracts state that it is proper for reinsurers to mention in some way their excess of loss reinsurance, with which we agree; but that is far different from attempting the impossible by picking out one of the six amounts (see our Opening Brief, p. 51) which might be used in deducting excess of loss reinsurance from the reinsured's gross insurance.

J. INTERPRETATION BY APPELLEE'S WITNESSES OF "NETT RETAINED LINES"

We next, on page 39 of Appellee's Brief, see an attempted explanation of the fact that all of the Appellee's witnesses adopted as a matter of course the definition of "nett retained lines only" as contained in Appellant's catastrophe reinsurance contract, Plaintiff's Exhibit 1, to mean $50,000. Now, there is absolutely no definition attempted in this catastrophe contract of "nett retained lines." There it stands without any attempt at definition contained in the contract. We fully agree with Appellee's counsel's statement that, of course, in construing this

policy anybody would take it that nett retained lines meant in this case $50,000, and we collected from Lloyd's on that basis; but, that merely goes to show that "net retained lines" in reinsurance parlance always means exactly what Appellant's witnesses stated it meant: the "gross amount less specific reinsurance."

K. THE SIX VARIANT METHODS OF COMPUTING "NET RETENTION"

Beginning on page 40, Appellee's Brief attempts to answer our question of the six variant methods of determining the proper deduction from the gross insurance on account of excess of loss reinsurance, but all that we can gather out of this explanation is that, of course, it was the duty of appellant "to frankly state its maximum liability with respect to this bridge in the event of a total loss." Now, why "a total loss" and why a loss on this one subject matter of insurance "unconnected with any other loss." There is absolutely nothing in the contract which justifies any assumption that this problem is to be computed so that the result shall be $18,000. The only reason that this Court is asked to compute this problem in this manner is that the Appellee has itself seen fit to compute it that way and has also framed its questions that its witnesses were compelled to do the same. Why go so far as to assume that this bridge might be a total loss and stop right there without any assumption whatever that no other property upon which the Appellant carries insurance is going to be lost in the same catastrophe? Most certainly a catastrophe that

would have wiped out this bridge, including piers, superstructure, cable anchorage, approach, grading and paving, and so forth, would have damaged other property upon which Appellant carried insurance. So let us repeat, why go so far as either to assume a total loss of this property or there to stop short off without assuming a loss of any other property whatsoever? Appellee's Counsel utterly fail to undertake the answering of this interesting question. The parties to the contract had entered into the contract upon the basis that it was the judgment of the reinsured company that a 50% loss was the utmost loss which could be expected, and under the terms of the contract this judgment of the Appellant company was absolutely binding upon the Appellee. So why interpret this contract by assuming that it was made in contemplation of a total loss? If the contract had been made in contemplation of computing net retention on the basis of actual loss, then alternative No. 4 was the proper amount to be deducted. Furthermore, there is not the slightest reason why alternative No. 1 should not be adopted if excess of loss reinsurance is to be taken into account. If we are to use maximum amounts there is no question but what $153,000 was the maximum amount that the Lloyd's organization might be called upon to pay under this policy. Appellee's Counsel say that this is absurd to talk about deducting $153,000 from $50,000. So do we so say; but there is just as much reason, so far as interpretation of the contract is concerned for adopting any one of these alternatives as there is for adopting any other. A probable reason of Appellee's for adopting

this claim that $18,000 should be deducted might be that it was hoping that this amount would be agreed upon as a reasonable compromise settlement. *At least, there is no other reason which comes within even the range of the plausible.*

L. APPELLEE'S NOTICE OR KNOWLEDGE OF THE EXISTENCE OF APPELLANT'S CATASTROPHE INSURANCE

Beginning with page 43, Appellee's Brief, attempts to minimize the effects of the various methods by which the Appellee obtained knowledge of this catastrophe insurance. It first attacks the conference between Mr. Beall and Mr. Easton, upon the ground that "It was a general conference concerning their underwriting programs, etc." On the contrary, it was a special conference caused by Mr. Easton looking Mr. Beall up and proposing this very reinsurance relationship.

In the language of Mr. Beall, "he offered an equal line with us * * * and I went into a great deal more detail than I normally would (Tr. 226). * * * We had a complete discussion of our underwriting program and of the reinsurance each company carried" (Tr. 277).

In other words, this information was conveyed specifically in order to form a basis of the entering into this reinsurance contract relationship. *And there is no attempt to deny this by the production of any testimony.*

As to the use of Best's, the reasons given on page 45 to 47 for the Appellee's not referring to Best's do not agree with the reason given by Mr. Legris,

which was as shown on pages 47 and 48 of our Opening Brief, and was practically summed up in the last sentence regarding their knowledge of this catastrophe insurance: "*I would assume we knew it, because it is a common practice.*"

As to the testimony of Mr. Sullivan regarding statements of this catastrophe reinsurance, contained in the examination reports, as stated in our Opening Brief, all that these Exhibits show "is that Counsel for the Appellee, after searching through the Department records, was able to find three reports which did not specifically state the amounts of the excess reinsurance."

M. WHAT IS THE APPELLANT'S THEORY?

Next we come upon the astounding statement that "appellant contends that when it wrote the insurance upon the Tacoma Narrows Bridge it concluded that the bridge constituted two risks." Furthermore, in the course of this argument, they attempt to state what the Appellant should have stated in the various documents, even going so far as to say that the Appellant, in its letter of October 1, 1941, Defendant's Exhibit A-8, Tr. 97, should have stated some sort of argument in favor of a two-risk theory. To sum up this, we have fully covered what our theory was, and that is that, as stated in Defendant's Exhibit A-8, the Appellant had in good faith fixed a PML of 50% and had so stated upon the reinsurance certificate. This has been the Appellant's theory from the start and it is rather a novel procedure, to say the least, for Appellee to seek to garble that theory by dragging in an insurance man's term "two-risk" which, to any-

one other than an insurance man, has a very different meaning from what was intended.

In this connection, however, we would call attention to the fact that Counsel for the Appellee further make no attempt to answer our statement contained on page 40 of our Opening Brief that they were very meticulous about asking each one of their witnesses whether PML indicated the number of risks involved (which manifestly could be answered in the negative), but *they never asked a single witness whether PML expressed any idea of the size of the maximum "one risk" involved.*

We believe that we have already completely covered Mr. Towers' claim that calling a single bridge more than one risk was equivalent to an attempt to make black out of white. Further, on page 61, we learn for the first time that we are claiming that the "Court should read into Appellant's daily report (Defendant's Exhibit A-5) some such declaration as this 'Northwestern finds that the bridge constitutes two risks and, therefore, cedes to Union under the Treaty $25,000 on each of two risks'." What we do assert is that, according to Mr. Legris' own statement, the term PML 50% which appears in that exhibit meant to him that the maximum risk involved in this insurance was 50%, and that the Appellee has never attempted to deny this statement and that Appellee's Counsel now attempt to meet it by merely attempting to first falsely misstate the claim in such a way as to make it appear ridiculous.

On pages 62 and 63, we find the argument that there were various ideas relative to what constitutes

one risk, and, also, as to everything which PML might signify. Such an argument, however, has no place in this case. As we have frequently stated, the contract itself left up to the Appellant the duty of stating what constituted one risk and during the passing of letters between the parties relative to adjusting this loss, the Appellee had declared itself satisfied that they had not at any time questioned this point (Tr. 46). If the Appellant had been guilty of any fraud in understating this "one loss," it would have been a complete defense to any recovery whatsoever in this action; but no such defense was ever raised, and, therefore, the action of the Appellant in fixing one risk in this matter at 50% is not a subject of dispute in this case. Neither do refined definitions about the meaning of PML have any place in this case. As we showed upon page 38 of our Opening Brief, Mr. Legris, the officer of the Appellee who was representing the Appellee at the trial of this case, agreed with Appellant's Counsel's statement that "It is understood that there is no greater risk involved than the estimated PML," and Appellee's Brief has not even dignified this statement by referring to it. Therefore, refined arguments about other meanings of PML, what constitutes one risk and what may be meant by such phrases as two risks, three risks or four risks, have no place in this case.

On page 41 of our Opening Brief, we devoted some attention to Defendant's Exhibit A-17, and showed the meaning of the various sheets contained in that exhibit. As a final misstatement, we find the suggestion that Appellant should have stated, "Bridge

underwritten as two separate risks of $25,000 each and $25,000 is ceded on each risk." Once more, we state positively that this is not and never was our contention and that our contention was that the maximum risk involved in the insurance on this bridge was 50%, and that this fact was properly communicated to the Appellee by the expression PML 50% and the Appellee understood at the time that that expression meant exactly what our claim is; and that is, that it was the honest opinion of the underwriters of the Appellant that the greatest possible risk involved in the writing of this insurance was 50% of the amount of the insurance.

N. CONCLUSION

We would respectfully submit that the Appellee has made not the slightest attempt to answer the points submitted by us in our Opening Brief, but have adopted the course of attempting to state that we have asserted claims which we in fact have never asserted and which are perfectly silly upon their faces, and then have proceeded to demolish such bogus claims. We therefore submit that the essential facts in this case are as stated in our Opening Brief: that the Appellee has not seen fit to point out where a denial of any of these facts can be found in the record, and that these facts entitled the Appellant to judgment as prayed for.

Respectfully submitted,

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